Formal banks, semi-formal SHGs or informal moneylenders, who is better? a study of borrower credit preference in India

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The present study explores the factors driving borrowers' preference for formal banks, self-help groups (SHGs) and moneylenders. The study is based on a systematic survey of 839 rural borrowers from southern India, sampled from four districts with varied levels of credit access (surplus, constrained and moderate credit). The data was analysed using multinomial logistic regression in SPSS. Results show how banks and moneylenders exclude borrowers based on relative wealth and gender. SHGs service women borrowers but are preferred more by wealthier borrowers, highlighting intragroup inequalities. Yet, the three lenders service a variety of purposes, justifying their demand in the market. The study enhances understanding of rural borrowers' constraints concerning various credit sources. The implications of this study are as follows: one is identifying the lacunae in the formal banking system, which policy amendments could address. Two, the study recommends an investigation of intragroup inequalities within SHGs. Third, the study underscores the demand for multiple players in the rural credit markets and their contribution to the borrower's credit needs.

Keywords: Agency theory, banks, moneylenders, preference, self-help groups.

Banks practised financial exclusion on the grounds of compulsory collateral[6,7] and the limited purposes for which loans were extended (for agriculture and housing)[6,8]. Banks collaborated with moneylenders by extending credit to them during high-demand seasons. Moneylenders, in turn, lent to borrowers, particularly in seasons when loans were high in demand. In other words, moneylenders act as middlemen between banks and borrowers, particularly when shocks like natural calamities induce demand[9].

Self-help groups (SHGs) were designed to empower the borrowers through their enhanced agency[10], which achieved the same only if certain conditions like training and self-employment were met[11]. The social capital required for SHG membership was exclusive to dominant groups (males, upper castes and superior occupational classes), widening social inequality[12]. Furthermore, the credit disbursed through SHGs was diverted for consumption purposes[5,13].

Studies have examined the positives and negatives of formal banks (formal banks as nationalized banks and regional rural banks (RRBs), operating in rural Andhra Pradesh), semi-formal SHGs (semi-formal SHGs refer to the self-help groups extending credit through SHG–bank linkage programme) and informal